

## CITY OF ALAMEDA

### Memorandum

To: Honorable Mayor and  
Members of the City Council

From: John A. Russo  
City Manager

Date: November 1, 2011

Re: Accept the Annual Investment Report for FY10-11

### BACKGROUND

In June 2002, the City Council contracted with Public Financial Management, Inc. (PFM) and Chandler Asset Management, Inc., for portfolio management services for investment of the City's "idle cash" in accordance with this policy. Annually, the City Council adopts or reaffirms the City Investment Policy, which establishes the objectives of Safety of Principal, Liquidity, and Yield. Additionally, the policy limits investment in companies that produce or manufacture cigarettes, alcohol, or gambling products.

### DISCUSSION

This agenda item reports on the results of the ninth year of the City's managed portfolio by PFM and Chandler Asset Management. PFM, per contract, prepares this year-end "consolidated" report for both managed portfolios. (Exhibit 1)

The investment policy objectives, which were achieved during this reporting period, are as follows:

- Safety of Principal:
  - Each investment held for the City has good credit quality.
  - Maturity distribution was structured to protect the portfolio ensuring against a volatile investment environment.
- Liquidity:
  - Portfolio diversification was enhanced to capitalize on the investment sectors and issuers offering the greatest value in the market
- Yield:
  - Exceeded the industry-standard benchmarks to provide a solid return.

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During FY10-11, the portfolio reduced its investment position in U.S. Treasury notes and increased its position in Federal Agency securities and Corporate Notes. As a result of these changes, the portfolio's overall yield was maximized, while still maintaining excellent overall credit quality. Approximately 67% of the portfolio remains in the one to three year range of maturities, which is the point of best relative value in the present market.

The overall return for the managed composite portfolio as of June 30, 2011 was 1.68%, and since inception of the program was 3.98%. This compares favorably to the two-year U.S. treasury rate of .46% as of June 30, 2011 and the Merrill Lynch benchmark earnings since inception of 3.65%, a difference of 0.33%, or approximately \$273,000.

#### FINANCIAL IMPACT

The value added by employing outside investment managers is the ability to evaluate and focus on those maturities and sectors that may offer the best relative value. The managed portfolio earned .33% more than the benchmark of 3.65%, demonstrating the benefit of this approach. In addition to earning returns that exceed the benchmark, staff time is available to perform other functions thereby increasing department productivity.

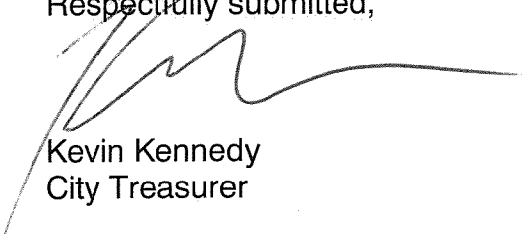
#### MUNICIPAL CODE / POLICY DOCUMENT CROSS REFERENCE

This annual report on the City's investments is in accordance with the City's Investment Policy.

#### RECOMMENDATION

Accept the Annual Investment Report for FY10-11.

Respectfully submitted,



Kevin Kennedy  
City Treasurer

Approved as to funds and account,



Fred Marsh  
Controller

Exhibits:

- 1 PFM/Portfolio Review
- 2 PFM/Chandler Managed Account Detail of Securities Held - on file in the City Clerk's Office

cc: Chandler Asset Management w/o exhibits  
PFM Asset Management w/o exhibits



## City of Alameda Portfolio Review Fiscal Year 2010-2011

**PFM Asset Management LLC**  
50 California Street, Suite 2300  
San Francisco, CA 94111  
415-982-5544



## Accomplishments

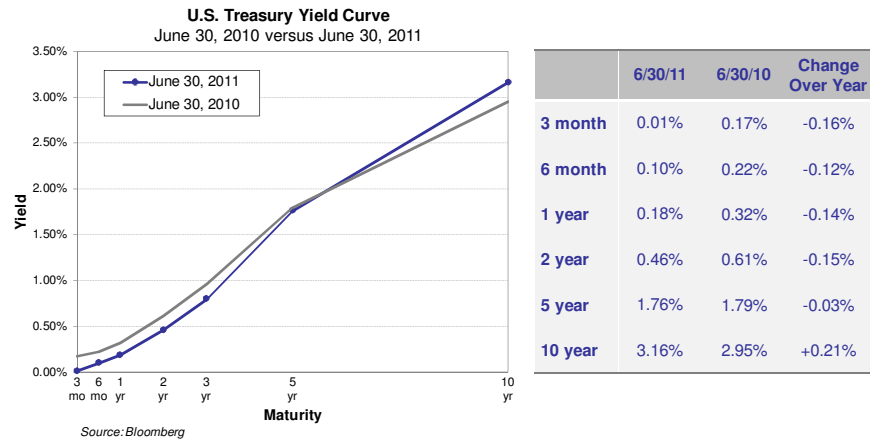
The City hired two investment advisors (PFM Asset Management LLC and Chandler Asset Management) in June 2002.

### **FY 10/11 Strategies and Accomplishments:**

- The City's combined securities portfolios had a total return of 3.98% for the fiscal year.
- 73% of the portfolio (excluding LAIF) is invested in securities issued or backed by the U.S. Government or its Agencies.
- The portfolio is highly rated.
- The portfolio is well diversified across issuers and sectors.



## Yields at Historical Lows



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## Aggregate Portfolio Balances

- The portfolio complies with the City of Alameda's Investment Policy and with the California Government Code.

Security Types	As of June 30, 2011	Percentage of Portfolio	Permitted by Policy	In Compliance
U.S. Treasuries	\$16,602,402	20%	100%	✓
Federal Agencies	\$39,795,531	48%	75%	✓
FDIC-Guaranteed Corporate Notes	\$4,140,402	5%	30%	✓
Corporate Notes/Bonds	\$21,309,135	26%	30%	✓
Municipal Obligations	\$811,493	1%	100%	✓
Money Market Fund	\$117,661	<0.1%	20%	✓
<b>Total</b>	<b>\$82,776,624</b>	<b>100%</b>		

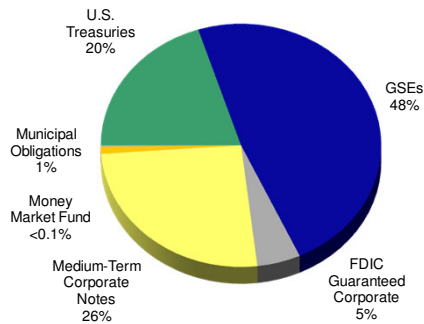
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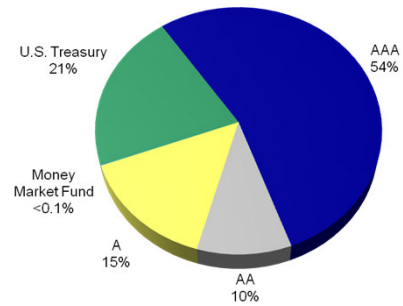
## Aggregate Portfolio Distributions

- The City's portfolio is well diversified and has good credit quality.

**Sector Distribution  
as of June 30, 2011**



**Credit Quality Distribution  
as of June 30, 2011<sup>1</sup>**



1. Ratings by Standard & Poor's as of June 30, 2011. On August 5 S&P downgraded the U.S. sovereign rating to AA+. The debt of Federal Agencies of the U.S. Government were subsequently downgraded to AA+ as well.

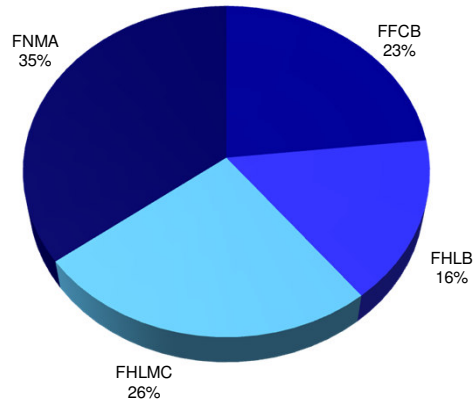
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## Agency Sector Diversified Among Corporations

- Federal Agency securities make up 48% of the total portfolio. Agency securities are well diversified amongst the issuing government sponsored enterprises.

**Aggregate Portfolio Agency Holdings  
June 30, 2011**

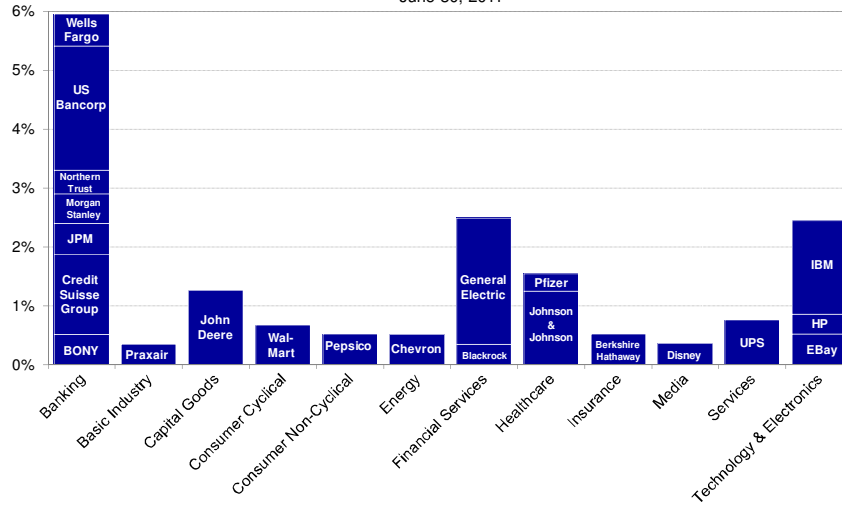


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## Corporate Holdings Diversified by Type and Issuer

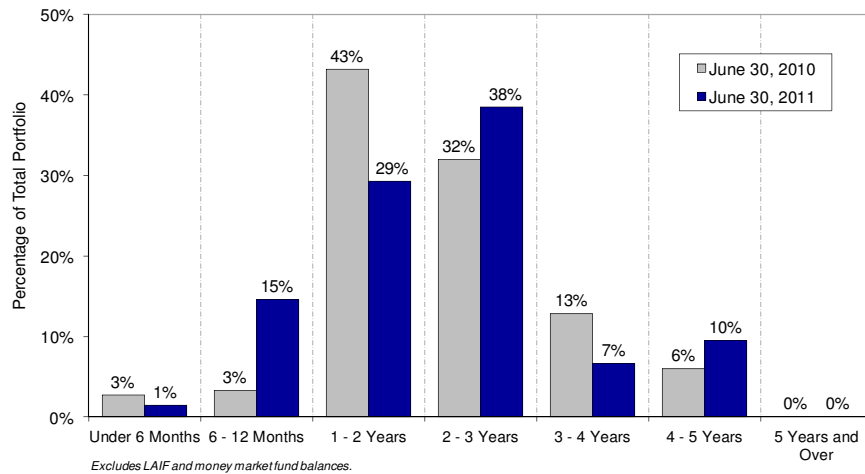
Aggregate Portfolio Corporate Holdings  
June 30, 2011



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## Aggregate Portfolio Maturity Distribution



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## Aggregate Portfolio Performance

- The City's aggregate portfolio has outperformed standard industry benchmarks since the advisors began managing the funds in 2002.

	Total Return Since Inception <sup>1</sup>
<b>City of Alameda</b>	<b>3.98%</b>
Combined Benchmark <sup>2</sup> (Merrill Lynch 1-3 Year Government Index and Merrill Lynch 1-5 Year Government Index)	3.65%

<sup>1</sup>Inception date is June 30, 2002

<sup>2</sup>Combined benchmark performance computed using equal weighting

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## Portfolio Positions and FY Earnings

As of 6/30/11	1-3 Year Benchmark Portfolio	1-5 Year Benchmark Portfolio	Combined Portfolios
Market Value <sup>1</sup>	\$40,151,453	\$42,095,746	\$82,247,199
Amortized Cost	\$39,944,700	\$41,157,192	\$81,101,892
Original Cost	\$39,993,871	\$41,546,650	\$81,540,521
Yield to Maturity at Cost	0.91%	2.42%	1.68%
Duration to Worst	1.76	2.31	2.04
<b>Fiscal Year Earnings (Amortized)<sup>2</sup></b>	<b>\$761,000</b>	<b>\$1,567,504</b>	<b>\$2,328,504</b>
<b>Fiscal Year Earnings (Original Cost)<sup>2</sup></b>	<b>\$768,596</b>	<b>\$1,670,300</b>	<b>\$2,438,896</b>
<b>Fiscal YTD Unrealized Gain<sup>1,3</sup></b>	<b>\$206,752</b>	<b>\$938,554</b>	<b>\$1,145,306</b>

1. End of month trade-date market values of portfolio holdings.

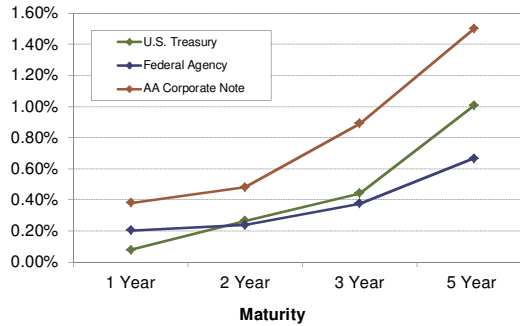
2. Calculated on Settlement Date Basis.

3. Calculated by subtracting the amortized cost from the market value.

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## Current Interest Rate Environment



	1 Year	2 Year	3 Year	5 Year
U.S. Treasury	0.08%	0.27%	0.44%	1.00%
Federal Agency	0.20%	0.24%	0.38%	0.67%
AA Corporate Note	0.38%	0.48%	0.89%	1.50%

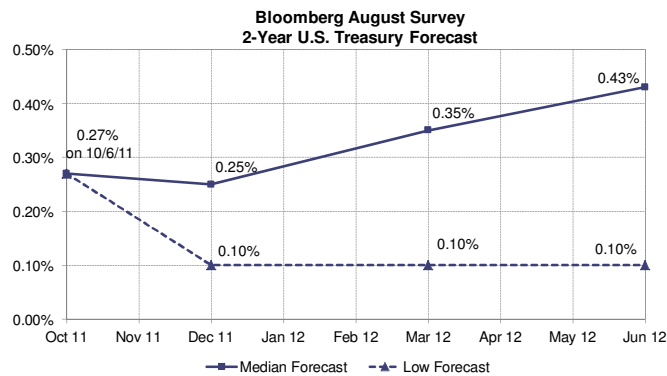
Rates as of 10/6/11

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## Earnings Forecast

Alameda Earnings Forecast (FY 11-12)	Earnings Rate
Median Forecast	1.46%
Low Forecast	1.43%



Methodology and assumptions:

- **Beginning Portfolio:** The baseline for the projections is the existing portfolio as of 9/6/11 using the actual yield-on-cost of each investment in the portfolio.
- **Reinvestment Rate Assumption:** For each maturity/call during the projection period, we assume a reinvestment rate based on a market forecast. For simplicity, these rates are based on the median and low forecast for the 2-year Treasury note yield from Bloomberg's August 2011 survey of economists.
- **Cash Flows:** We assume there are no cash flows into or out of the portfolio during the projection period.

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## Economic Outlook and Strategy

- Market tensions have run high recently as economic prospects appear dim; doubts about European solvency have deepened, and policymakers are struggling to forge remedies. Consumer and business confidence has slipped amid heightened uncertainty over economic and fiscal policy.
- The Federal Reserve took a bold step in its August FOMC announcement, explicitly saying they would likely keep its target rate close to zero until mid-2013 in hopes to spur economic growth.
- We will continue to work with the City to focus on maintaining the safety of the invested principal and achieving the City's long-term investment objectives.



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## Disclaimer

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